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Peoples Gas Exhibit No. A
Witness
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Exhibit A

ILLINOIS COMMERCE COMMISSION

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CHIEF CLERK'S OFFICE

THE PEOPLES GAS LIGHT AND COKE COMPANY)
)
) Docket No. 00-
Petition under Section 5-104 of the Public)
Utilities Act for authority to revise)
depreciation rates applicable to depreciable)
gas plant.)

DIRECT TESTIMONY OF
WILLIAM M. STOUT

1. Q. Please state your name and business address.

A. My name is William M. Stout, and my business address is 207 Senate Avenue, Camp Hill, Pennsylvania.

2. Q. By whom are you employed and in what capacity?

A. I am employed by Gannett Fleming Valuation and Rate Consultants, Inc., as President.

3. Q. Please describe the firm of Gannett Fleming Valuation and Rate Consultants, Inc.

A. Gannett Fleming Valuation and Rate Consultants, Inc., a subsidiary of Gannett Fleming Affiliates, Inc., provides consulting services to public utilities and railroads. The Gannett Fleming affiliated companies employ over 1,900 people in 40 offices throughout the United States.

Gannett Fleming Valuation and Rate Consultants, Inc., and its predecessor, the Valuation Division of Gannett Fleming Corddry and

Carpenter, Inc., have a long history of client services encompassing valuations; depreciation studies; revenue requirement, cost allocation and rate design studies; analyses of accounting systems; and acquisition and feasibility studies.

4. Q. Please state briefly your educational background and employment experience.

A. I have a Bachelor of Science degree in Management Engineering from Rensselaer Polytechnic Institute. While attending Rensselaer, I was employed by the Valuation Division of Gannett Fleming Corddry and Carpenter, Inc., during the summers of 1970, 1971 and 1972. My principal assignments related to valuation studies and computer programming.

After my graduation in June 1973, I was employed by the Valuation Division as a Valuation Engineer. The scope of my depreciation activities has included assembly of basic data, statistical service life analyses utilizing the retirement rate and simulated plant record methods, field surveys, preparation of preliminary estimates of service life, calculation of annual and accrued depreciation, and preparation of reports presenting the results of the studies.

The scope of my cost of service activities has included the selection of customers to be demand-metered, the analysis of recorded customer demands, the development of cost allocation factors, the allocation of costs, the analysis of customers' consumption, the application of present and proposed rates to the consumption analysis, the design of rate structures, and the preparation of reports presenting the results of the studies.

Since January 1978, I have testified in support of the studies conducted under my direct supervision. In January 1980, I was assigned to the position of Manager of Depreciation and Cost Allocation Studies conducted by the Valuation Division. In June 1982, subsequent to a corporate reorganization, I became a Vice President of Gannett Fleming Valuation and Rate Consultants, Inc. I became a Senior Vice President in 1991, and attained my current position of President in 1994.

5. Q. Are you a registered professional engineer?

A. Yes. I am registered in the Commonwealth of Pennsylvania.

6. Q. Are you a member of any professional societies?

A. Yes, I am a member of the National and Pennsylvania Societies of Professional Engineers, the Institute of Industrial Engineers, the Society of Depreciation Professionals (SDP), the National Association of Water Companies, the American Gas Association (AGA), and the American Water Works Association (AWWA). I am a former member of the Rates & Charges Subcommittee of AWWA, a past president of SDP, and a member of the Accounting Services Committee of AGA.

7. Q. Do your professional activities include participation in continuing professional educational programs?

A. Yes. I have completed the "Fundamentals of Life Estimation," "Forecasting Service Life," and "Making and Administering [Depreciation] Policy" programs conducted by the Center for Depreciation Studies at Western Michigan University. In 1985 I became a member of the faculty of Depreciation Programs, Inc., lecturing on "Forecasting Service Life,"

"Fundamentals of Salvage Analysis", and "Managing a Depreciation Study". I also am an instructor at the annual Introduction to Public Utility Accounting and Advanced Accounting Seminars sponsored by AGA.

8. Q. Have you previously testified on the subject of depreciation?

A. Yes, I have testified on the subject of depreciation before the Pennsylvania Public Utility Commission, the Georgia Public Service Commission, the Indiana Utility Regulatory Commission, the New York Public Service Commission, the Regulatory Commission of Alaska, the Texas Public Utility Commission, the New Hampshire Public Utilities Commission, the Alberta Energy & Utilities Board, the Newfoundland Board of Commissioners of Public Utilities, the Federal Energy Regulatory Commission, the National Energy Board of Canada, the Canadian Radio-Television and Telecommunications Commission and the United States Tax Court.

9. Q. Have your previously testified before the ICC?

A. Yes. I testified on the subjects of cost of service allocation and customer rate design on behalf of Illinois-American Water Company in ICC Dockets 95-0076 and 97-0102.

10. Q. What is the purpose of your testimony?

A. The purpose of my testimony is to submit evidence supporting the petition of The Peoples Gas Light and Coke Company (the Company, Peoples or Petitioner) for approval of a change in depreciation rates based on a new average service life study as required by the Illinois Commerce Commission (ICC) in the Company's last rate order, Docket 95-0032, dated November 8, 1995.

11. Q. What were the ICC's requirements of the Company with respect to depreciation in its order in Docket 95-0032?

A. The order required the Company to perform depreciation studies every five years, commencing with the date of the order, and to request Commission approval for any change in depreciation rates in the future. Thus, the Company contracted with Gannett Fleming Valuation and Rate Consultants, Inc. to perform a depreciation study (the Study) to estimate average lives and survivor curves and to determine depreciation rates based on property data as of December 31, 1999, for the type groups and plant accounts of the Company.

12. Q. Please describe what you mean by the term "depreciation".

A. My use of the term "depreciation" is in accord with the definition set forth in the ICC's Uniform System of Accounts for Gas Utilities. "Depreciation" refers to the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of gas plant in the course of service from causes which are known to be in current operation, against which the company is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities, and, in the case of natural gas companies, the exhaustion of natural resources.

In the Study that I performed and that is the basis for my testimony, I used the straight line remaining life method of depreciation with the average service life procedure. In the remaining life method, the annual

depreciation is based on a system of depreciation accounting which aims to distribute the unrecovered cost of fixed capital assets over the estimated remaining useful life of the unit, or group of assets, in a systematic and rational manner.

13. Q. Have you prepared an exhibit presenting the results of your depreciation Study?

A. Yes. Exhibit No. 1 presents the results of the depreciation Study as of December 31, 1999.

14. Q. How did you determine the annual depreciation?

A. The determination of annual depreciation consists of two phases. In the first phase, service life characteristics are estimated for each Type Group, that is, each plant account or subaccount identified as having similar characteristics. In the second phase, the composite remaining lives and annual depreciation are calculated based on the service life estimates determined in the first phase.

15. Q. Please describe the first phase of the Study, that is, the manner in which you estimated the service life characteristics for each Type Group.

A. The service life Study consisted of compiling historical data from records related to Peoples' gas plant; analyzing these data to obtain historical trends of survivor characteristics; obtaining supplementary information from management and operating personnel concerning Peoples' practices and plans as they relate to plant operations; and interpreting the above data to form judgments of average service life characteristics.

16. Q. What historical data did you analyze for the purpose of estimating the service life characteristics of Peoples' gas plant?

A. The data consisted of the entries made by Peoples to record gas plant transactions through December 1999. The transactions included additions, retirements, transfers, and the related balances. The data were classified by depreciable group, type of transaction, the year in which the transaction took place, and the year in which the plant was installed.

17. Q. What method did you use to analyze this service life data?

A. I used the retirement rate method. That method is the most appropriate when aged retirement data are available, because it develops the average rates of retirement actually experienced during the period of study. Other methods of life analysis infer the rates of retirement based on a selected type survivor curve.

18. Q. Please describe the results of your use of the retirement rate method.

A. Each retirement rate analysis resulted in a life table which, when plotted, formed an original survivor curve. Each original survivor curve as plotted from the life table represents the average survivor pattern experienced by the several vintage groups during the experience band studied. Inasmuch as this survivor pattern does not necessarily describe the life characteristics of the property group, interpretation of the original curves is required in order to use them as valid considerations in service life estimation. Iowa type survivor curves were used in these interpretations.

19. Q. Please explain briefly what an "Iowa-type survivor curve" is and how you use it in estimating service life characteristics for each depreciable group.

A. The range of survivor characteristics usually experienced by utility and industrial properties is encompassed by a system of generalized survivor curves known as the Iowa-type curves. The Iowa curves were developed at the Iowa State College Engineering Experiment Station through an extensive process of observation and classification of the ages at which industrial property had been retired.

Iowa-type curves are used to smooth and extrapolate original survivor curves determined by the retirement rate method. The Iowa curves were used in the Study to describe the forecasted rates of retirement based on the observed rates of retirement and the qualitative outlook for future retirements.

The estimated survivor curve designations for each Type Group indicate the average service life, the family within the Iowa system and the relative height of the mode. For example, the Iowa 65-R2.5 indicates an average service life of sixty-five years; a Right mode, or R, type curve (the mode occurs to the right of average life for right mode curves); and a medium height, 2.5, for the mode (possible modes for R type curves range from 0.5 to 5).

20. Q. Did you physically observe Peoples' plant and equipment in the field?

A. Yes. A field trip was conducted in order to be familiar with Company operations and to observe representative portions of the plant. A general understanding of the function of plant and information with respect to the reasons for past retirements and the expected future causes of retirements was obtained during my review of Company facilities. This knowledge and

information were incorporated in the interpretation and extrapolation of the statistical analyses.

21. Q. Please describe the second phase of the Study, the calculation of composite remaining lives and the determination of annual depreciation.

A. After I estimated the service life characteristics for each depreciable group, I calculated annual depreciation accrual amounts for each group in accordance with the straight line remaining life method, using remaining lives consistent with the average service life procedure.

22. Q. Please describe briefly the straight line remaining life method of depreciation that you used for depreciable property.

A. The straight line remaining life method of depreciation allocates the original cost less accumulated depreciation in equal amounts to each year of remaining service life.

23. Q. Please describe briefly the average service life procedure.

A. In the average service life procedure, the remaining life annual accrual for each vintage is determined by dividing future book accruals (original cost less book reserve) by the average remaining life of the vintage. The average remaining life is a directly weighted average derived from the estimated survivor curve.

24. Q. Please outline the contents of Exhibit No. 1.

A. Exhibit No. 1 is presented in three parts. Part I. Introduction includes statements related to the scope of and the basis for the depreciation Study. Part II. Methods Used in the Estimation of Depreciation includes descrip-

tions of the estimation of survivor curves and the calculation of annual and accrued depreciation.

Part III. Results of Study presents a description of the results, summaries of the depreciation calculations, graphs and tables which relate to the service life Study, and the detailed depreciation calculations.

The table on pages III-4 through III-8 presents the estimated survivor curve, the original cost at December 31, 1999, and the book reserve and calculated annual depreciation amount and rate for each account or subaccount of gas plant.

The section, beginning on page III-9, presents the results of the retirement rate analyses prepared as the historical bases for the service life estimates. The section, beginning on page III-184, presents the calculation of annual depreciation by vintage by account for each classification of gas plant.

25. Q. Please illustrate the procedure followed in your depreciation Study and the manner in which it is presented in Exhibit No. 1 using an account as an example.

A. I will use Account 376.1, Mains, to illustrate the manner in which the Study was conducted. Account 376.1, Mains, represents 31 percent of the total plant. As the initial step of the service life Study phase, aged plant accounting data were compiled for the years through 1999. These data have been coded in the course of Peoples' normal recordkeeping according to account or property group, type of transaction, year in which the transaction took place, and year in which the gas plant was placed in service. The re-

tirements, plant additions and other plant transactions were analyzed by the retirement rate method.

For example, for Account 376.1, Mains – Steel (Type Group 092), the data were subdivided for study into two experience bands, 1939-1999 and 1970-1999. These experience bands are of sufficient length to smooth fluctuations in the level of retirements. The resulting life tables are presented on pages III-70 through III-75 of Exhibit No. 1. These two bands, as well as the 65-R2.5 survivor curve, which was selected to represent the average survivor characteristics, are plotted on page III-69. Similar analyses for the remaining Type Groups in the account were conducted and are presented on pages III-51 through III-68.

The calculation of the annual depreciation accrual rate, the second phase, for the original cost of mains in service at December 31, 1999, is presented, by vintage, on pages III-221 through III-232 of Exhibit No. 1. The expectancy and average life derived from the survivor curve for each vintage within each Type Group were used to calculate the accrued depreciation.

The book reserve was allocated to Type Groups and vintages based on the calculated accrued depreciation. The remaining lives of the vintages were based on the respective survivor curve estimates, the Iowa 65-R2.5 survivor curve in the case of steel mains, and the attained age. The future book accruals (original cost less allocated book reserve) were divided by the remaining lives to derive the annual depreciation accruals by vintage.

26. Q. Is the procedure you described for Account 376.1, Mains – Steel, typical of that followed for most of the plant investment?

A. Yes, it is, inasmuch as the straight line method with the average service life procedure was used for all depreciable plant.

27. Q. What do you recommend regarding Peoples' implementation of the average lives and survivor curves that you estimated?

A. I recommend that the average lives and survivor curves that I have estimated be used in the calculation of annual depreciation beginning with Peoples' fiscal year 2001 (October 1, 2000 through September 30, 2001).

28. Q. What was the purpose of the calculation of annual depreciation accrual rates as of December 31, 1999?

A. The purpose of the December 31, 1999, calculation was to provide Peoples and the ICC with an approximation of the amount of annual depreciation based on the results of the Study.

29. Q. What is the annual depreciation based on the results of the Study?

A. The annual depreciation based on applicable property balances as of December 31, 1999, is approximately $55 million per year.

30. Q. Will you provide an update of your calculation of annual depreciation as shown in the schedule on pages III-4 through III-8 when September 30, 2000, data become available?

A. Yes, I will.

31. Q. Do you anticipate a materially different result between the Study and updated annual depreciation calculation as of September 30, 2000?

A. No, I do not.

32. Q. Does that conclude your direct testimony?

A. Yes, it does.